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## AEG Power Solutions B.V.

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# AEG Power Solutions B.V.

## Major Rating Factors

### Strengths:

- Market-leading position in its renewable energy solutions (RES) segment and good geographic diversity.
- Low capital intensity.
- Adequate liquidity with no meaningful debt amortizations until 2015.

### Corporate Credit Rating

B-/Positive/--

### Weaknesses:

- Volatile business with significant swings in end-market demand (particularly in RES) and profitability.
- High customer concentration, and reliance on a rebound in the solar energy market for future growth and profitability.
- Long production cycle for power controllers and reliance on customer advances, leading to volatile working capital requirements.
- Aggressive growth strategy, leading to relatively high leverage metrics on a fully Standard & Poor's-adjusted basis.

## Rationale

The long-term corporate credit rating on Netherlands-based AEG Power Solutions B.V. (AEG Power Solutions) reflects our view of the company's aggressive financial risk profile and vulnerable business risk profile. In our opinion, the rating is constrained by AEG Power Solutions' volatile and cyclical demand, resulting in low visibility, high customer concentration, and volatile working capital requirements. A further constraint, in our view, is AEG Power Solutions' significant reliance on a rebound in the solar energy market for future growth and profitability generation. These constraints are partly offset by AEG Power Solutions' good geographic diversification of revenues and the business' low capital intensity. Further rating support, in our view, comes from the company's long maturity profile and adequate liquidity, supported by an absence of maintenance financial covenants in the debt structure, including the notes issued by AEG Power Solutions' parent 3W Power Holdings S.A. (3W Power; not rated) in December 2010.

### Key business and profitability developments

We believe that strong order intakes in both the renewable energy solutions (RES) and energy efficiency solutions (EES) segments provide a solid basis for AEG Power Solutions to achieve its sales target of more than €400 million for financial year 2011, more than a 30% increase on 2010. In particular, the company's RES segment posted a 109% year-on-year increase in its order intake in the nine months ended Sept. 30, 2011, reflecting healthy demand for both its power controllers and solar inverter solutions. AEG Power Solutions' consolidated book-to-bill ratio of 1.1x in the first nine months of 2011 provides some degree of visibility for the rest of the year, as well as some comfort that the improving order intake trend will continue for the following 12 months. We forecast that AEG Power Solutions' profitability should benefit from the pick up in sales. We anticipate that an increase in profits, combined with a leaner cost structure as a result of the current restructuring program "Agenda 2012," will allow the company to improve fixed cost absorption, especially in the EES segment. We believe that AEG Power Solutions'

expansion into new locations, such as India and Eastern Europe, together with gaining access to new end markets, will allow the company to reduce earnings volatility and support long-term growth.

We anticipate that AEG Power Solutions will achieve EBITDA of about €40 million in 2011, corresponding to about a 10% EBITDA margin before our adjustments. We believe that the ongoing restructuring program, coupled with a healthy increase in revenue, would allow AEG Power Solutions to reach an EBITDA margin in the low teens by 2013, and to maintain that level.

### **Key cash flow and capital-structure developments**

In the 12 months to Sept. 30, 2011, AEG Power Solutions' ratio of funds from operations (FFO) to debt was 29% on the back of a healthy upward trend in profitability. FFO of €27 million in the period represented a €45 million year-on-year improvement from negative €18 million. However, free operating cash flow (FOCF) remained negative in the period, by €32 million, mainly due to a surge in working capital investment as sales increased. At the same time, AEG Power Solutions' debt-to-EBITDA leverage ratio improved to 3.6x.

We anticipate that the company will generate mildly negative FOCF in 2011, which should turn positive thereafter as the company tightens its working capital management and mutes its growth-related capital spending. We also believe that management will limit nonorganic growth to relatively small, bolt-on acquisitions. Our base-case credit scenario assumes a Standard & Poor's-adjusted ratio of gross debt (excluding the effect of €45 million surplus cash) to EBITDA of 4.5x by the end of 2011.

### **Liquidity**

We assess AEG Power Solutions' liquidity as adequate under our criteria.

We understand that primary sources of the company's liquidity are unrestricted cash balances about of €45 million (excluding the €50 million we assume the company needs for ongoing operations) and access to short-term lines of credit and factoring facilities, which we understand can be rolled over at maturity.

There are no meaningful near-term maturities before 2015, when the 9.25% notes issued by 3W Power come due, and AEG Power Solutions does not have any covenants governing its debt instruments.

Another source of liquidity is the advanced payments that the company receives for orders undertaken. We anticipate, however, that the proportion of customer prepayments in funding AEG Power Solutions' projects should decrease with time, in line with the company's strategy.

We also anticipate that AEG Power Solutions will generate positive FFO in the next 24 months. This should enable the company to maintain liquidity sources that cover estimated uses (such as working capital investment, maintenance and growth capital expenditures [capex], and modest acquisition spending) by at least 1.2x.

## **Outlook**

The positive outlook reflects our view that we could raise the rating on AEG Power Solutions if the company posts a steady improvement in credit measures supported by stable profitability and adequate liquidity. We consider the company's ability to generate EBITDA margins of 8%-10% on a fully adjusted basis as necessary to support FFO to debt of about 10% in 2011 and beyond on a fully adjusted gross debt basis. At the same time, we anticipate that AEG Power Solutions should sustain a debt-to-EBITDA ratio of less than 5x at all times on a gross debt basis (that

is, not taking surplus cash into account in its debt calculation). We estimate that AEG Power Solutions' FOCF will remain moderately negative in 2011, and turn positive thereafter.

We could revise the outlook to stable or lower the rating should AEG Power Solutions fail to sustain profitability high enough to generate cash and advance its growth strategy. This could occur if the increase in sales that we anticipate does not materialize, or if AEG Power Solutions is unable to maintain its cost base at a sufficiently low level. The rating could also come under pressure if the company's financial policy becomes more aggressive, leading to large debt-funded acquisitions; or if its liquidity position deteriorates from its current adequate level on the back of decreasing customer advances or high expansionary spending.

## Business Description

AEG Power Solutions is a global provider of highly engineered custom and standard power system solutions with a broad range of applications and a particular focus on the solar energy industry. The company manufactures devices used in polysilicon production, solar inverters for industrial and commercial applications, and custom and standard power system solutions for a range of industries. In 2010, AEG Power Solutions derived about one-quarter of its revenues from markets outside Europe. The company's product range encompasses a fair degree of customization and technological specialization. Furthermore, its business is highly dependent on customers' capital spending and commodity price movements, especially in polysilicon production.

## Business Risk Profile: Vulnerable; Affected By Unpredictable Demand And Earnings Volatility That Is Not Offset By Low Capital Intensity

The major risks for the vulnerable business risk profile are:

- AEG Power Solutions' volatile and late-cycle demand. The company's business is driven by the capex plans of its customers and commodity price movements (in particular, the spot price of polysilicon). This leads to low visibility and high execution risk, as some orders could be cancelled or delayed when regulations in renewable energy markets change.
- Volatile profitability. As AEG Power Solutions' sales drop because of a cyclical decline in its end markets, the company's margins come under pressure due to the increasingly large proportion of fixed costs in its cost base. Volatile profitability could also result from regulatory changes, leading to order delays and cancellations, as such changes have in the past. We believe that the company's EBITDA margins will likely remain volatile, albeit increasingly less sensitive to top-line declines when the restructuring program is complete.
- AEG Power Solutions' significant reliance on a rebound in the solar energy market for future growth and profitability generation. The photovoltaic energy industry is a small part (less than 1%) of the total power generation market. In developed countries, this industry has recently been adversely affected by the tough market conditions and decreases in government funding. In the past, these markets were widely seen as growth engines for the solar industry.
- High customer concentration. AEG Power Solutions has a relatively small number of customers and its top 10 customers accounted for approximately 70% of revenue in 2009. The company expects its dependence on a limited number of customers in both RES and EES segments to continue for the foreseeable future.
- The technology risks inherent in the photovoltaic and high-precision energy solutions industries. To sustain its leading market positions, AEG Power Solutions invests about 2%-4% of its revenues in research and

development.

These risks are partly mitigated by:

- AEG Power Solutions' leading positions in niche markets. The company is a global leader in the power control systems and modules subsegment, based on its technological advantage. In EES, a large installed equipment base somewhat mitigates the effect of weaker market positions.
- AEG Power Solutions' fair diversification of revenues. The company generates one-quarter of its revenues from outside Europe, although it still has significant operations in Germany. The company's recent entry into emerging markets, such as India and Eastern Europe, should allow it to benefit from renewable energy market growth that is anticipated from photovoltaic power projects in Asia, particularly in China and India, and in North America. In terms of product mix, the EES segment provides a more stable revenue stream than RES, but the latter has higher earning potential.
- Low capital intensity of the business. AEG Power Solutions' maintenance capex requirements are modest and have been in the €5 million-€10 million range in the past, according to management. We believe that this level will increase as the company increases in size. Given the limited scope of manufacturing operations performed by the company, we believe that AEG Power Solutions will maintain a relatively high rate of conversion of earnings into cash in the future.

## Financial Risk Profile: Aggressive; Credit Protection Measures Affected By Weak Cash Flow Generation

The main weaknesses of the aggressive financial risk profile are:

- AEG Power Solutions' weak cash flow generation as a result of weak operating profitability. We anticipate that the company will be net cash flow negative in the next 12 months, owing to its weak operating cash flow generation as a result of still-moderate sales volumes and the ongoing restructuring program. In addition, we do not anticipate that the company will generate positive FOCF in 2011. We believe that AEG Power Solutions will primarily use cash to fund its working capital needs, capex, and bolt-on acquisitions.
- AEG Power Solutions' dependence on customer prepayments. The company uses customer prepayments to finance its working capital needs. The first prepayment is normally received when the order is placed. Coupled with relatively long lead times for some of its products, this can result in surges in working capital requirements if the order intake of products with shorter production cycles exceeds the orders accompanied by customer advances, or if the total order intake declines. If customers reduce the amount of advance payments as a result of tougher competition in the market, this could also lead to higher working capital requirements.
- The company's aggressively leveraged capital structure. This stems from weak earnings in recent periods, coupled with a relatively high absolute debt level after the successful notes issuance by AEG Power Solutions' parent, 3W Power and considering the company's growth plans.

These weaknesses are partially mitigated by:

- The company's long-dated debt maturity profile and adequate liquidity. AEG Power Solutions' liquidity position benefits from the proceeds of a €100 million 9.25% notes issue. For liquidity purposes, AEG Power Solutions relies on surplus cash (about €45 million as of Sept. 30, 2011) and short-term credit and factoring lines, which we believe will be rolled over at maturity. We assume the company needs about €50 million to fund its ongoing

operations, which we therefore exclude in our liquidity assessment. There are no meaningful near-term maturities before 2015, when the notes come due.

- The absence of maintenance financial covenants. AEG Power Solutions' existing debt facilities and the unsecured notes issued by 3W Power do not contain any financial covenants. We believe this increases the company's ability to avoid pressure from creditors and related financial distress should its operating performance weaken.

## Financial Statistics/Adjustments

AEG Power Solutions reports its results according to International Financial Reporting Standards. Under our criteria, we make several adjustments to assess a company's financial position. Our standard adjustments include postretirement obligations in respect of AEG Power Solutions' defined benefit pension plan in Germany, operating leases, and capitalized development costs. In addition, we assume that up to €50 million (about 10% of annual sales in our forecast) of liquid assets are necessary for ongoing operations and as such are unavailable for debt repayment. We treat the rest as surplus cash and include it in our net debt adjustment (see table 1). However, in our assessment of AEG Power Solutions' credit quality, we rely on gross debt-based measures.

In addition to our standard adjustments listed above, we make a number of adjustments to the reported figures for the fiscal year ended Dec. 31, 2010. We make the adjustments in order to reverse the one-off effect on EBIT and EBITDA of the following items:

- €33 million of regular amortization of intangibles on acquisition;
- €47 million of impairment and accelerated amortization of intangibles; and
- €15 million of goodwill impairment.

**Table 1**

Reconciliation Of AEG Power Solutions B.V. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €)										
--Fiscal year ended Dec. 31, 2010--										
AEG Power Solutions B.V. reported amounts										
	Debt	Shareholders' equity	Revenues	EBITDA	Operating income	Interest expense	Cash flow from operations	Cash flow from operations	Dividends paid	Capital expenditures
Reported	120.6	279.7	306.0	(23.8)	(126.6)	1.3	(21.6)	(21.6)	--	28.8
Standard & Poor's adjustments										
Operating leases	11.0	--	--	0.3	0.3	0.3	3.4	3.4	--	8.7
Postretirement benefit obligations	17.6	2.5	--	(0.3)	(0.3)	1.0	(0.5)	(0.5)	--	--
Surplus cash and near-cash investments	(72.6)	--	--	--	--	--	--	--	--	--
Capitalized interest	--	--	--	--	--	0.1	(0.1)	(0.1)	--	(0.1)
Capitalized development costs	--	--	--	(4.7)	(2.8)	--	(4.7)	(4.7)	--	(4.7)
Share-based compensation expense	--	--	--	1.5	--	--	--	--	--	--

Table 1

Reconciliation Of AEG Power Solutions B.V. Reported Amounts With Standard & Poor's Adjusted Amounts (Mil. €) (cont.)										
Reclassification of nonoperating income (expenses)	--	--	--	--	0.8	--	--	--	--	--
Reclassification of interest, dividend, and tax cash flows	--	--	--	--	--	--	0.3	0.3	--	--
Reclassification of working-capital cash flow changes	--	--	--	--	--	--	--	4.0	--	--
Minority interests	--	0.7	--	--	--	--	--	--	--	--
Equity - Other	--	6.2	--	--	--	--	--	--	--	--
EBITDA - Inventory	--	--	--	12.9	12.9	--	--	--	--	--
EBITDA - Other income/(expense)	--	--	--	0.2	0.2	--	--	--	--	--
D&A - Impairment charges/(reversals)	--	--	--	--	94.3	--	--	--	--	--
Total adjustments	(44.0)	9.4	0.0	9.9	105.4	1.4	(1.6)	2.5	0.0	4.0
<b>Standard &amp; Poor's adjusted amounts</b>										

	Debt	Equity	Revenues	EBITDA	EBIT	Interest expense	Cash flow from operations	Funds from operations	Dividends paid	Capital expenditures
Adjusted	76.6	289.0	306.0	(13.9)	(21.2)	2.7	(23.2)	(19.1)	0.0	32.8

Table 2

AEG Power Solutions B.V. Peer Comparison					
	AEG Power Solutions B.V.	Kuka AG	Dometic Holding AB	Lantiq Beteiligungs-GmbH & Co. KG	Dematic Holding S.a.r.l.
Rating as of Nov. 29, 2011	B-/Positive/--	B/Stable/--	B/Stable/--	CCC+/Negative/--	B/Stable/--
(Mil. €)	--Fiscal year ended Dec. 31, 2010--			--Fiscal year ended Sept. 30, 2010--	
Revenues	306.0	1,078.6	882.5	323.8	608.4
EBITDA	(13.9)	47.5	148.9	56.2	47.7
Net income from continuing operations	(84.5)	(8.6)	5.7	(49.3)	42.5
Funds from operations (FFO)	(19.1)	(2.9)	84.6	12.4	34.7
Capital expenditures	32.8	15.1	26.9	16.1	36.9
Free operating cash flow	(55.9)	(38.2)	23.6	43.3	(8.1)
Discretionary cash flow	(55.9)	(38.2)	23.6	43.3	(8.1)
Cash and short-term investments	43.6	50.0	22.2	38.3	25.0
Debt	76.6	185.6	719.6	309.2	134.8
Equity	289.0	198.1	283.6	(48.3)	40.8
<b>Adjusted ratios</b>					
EBITDA margin (%)	(4.5)	4.4	16.9	17.3	7.8
EBITDA interest coverage (x)	(5.1)	1.2	4.0	2.7	5.6
EBIT interest coverage (x)	(7.8)	0.9	3.3	0.0	4.2
Return on capital (%)	(4.6)	9.6	11.4	0.1	31.0

**Table 2**

<b>AEG Power Solutions B.V. Peer Comparison (cont.)</b>					
FFO/debt (%)	(25.0)	(1.6)	11.8	4.0	25.8
Free operating cash flow/debt (%)	(73.0)	(20.6)	3.6	14.0	(6.0)
Debt/EBITDA (x)	(5.5)	3.9	4.8	5.5	2.8
Total debt/debt plus equity (%)	21.0	48.4	71.7	118.5	76.7

**Table 3**

<b>AEG Power Solutions B.V. Financial Summary</b>						
(Mil. €)	<b>--Rolling 12 months--</b>	<b>--Fiscal year ended Dec. 31--</b>				
	Ended Sept. 30, 2011	2010	2009	2008	2007	2006
Rating history	B-/Stable/--	B-/Stable/--	--/--/--	--/--/--	--/--/--	--/--/--
Revenues	397.2	306.0	407.3	342.8	218.2	247.2
EBITDA	25.9	(13.9)	23.9	56.1	1.9	2.3
Net income from continuing operations	(74.0)	(84.5)	(27.4)	35.9	(1.1)	(5.0)
Funds from operations (FFO)	26.6	(19.1)	49.5	50.9	(0.7)	(5.1)
Capital expenditures	18.1	32.8	13.2	6.8	3.1	9.4
Free operating cash flow	(31.6)	(55.9)	25.5	55.7	0.4	(19.2)
Discretionary cash flow	(31.6)	(55.9)	25.5	55.7	0.4	(19.2)
Cash and short-term investments	43.5	43.6	41.1	0.0	27.3	11.2
Debt	92.9	76.6	25.0	44.8	70.2	61.1
Equity	287.4	289.0	395.9	45.9	19.4	21.5
<b>Adjusted ratios</b>						
EBITDA margin (%)	6.5	(4.5)	5.9	16.4	0.9	0.9
EBITDA interest coverage (x)	2.5	(5.1)	1.4	14.8	0.5	0.6
EBIT interest coverage (x)	3.1	(7.8)	0.1	14.1	(0.3)	(0.3)
Return on capital (%)	7.1	(4.6)	0.5	57.1	(1.4)	(1.2)
FFO/debt (%)	28.6	(25.0)	197.7	113.5	(1.0)	(8.3)
Free operating cash flow/debt (%)	(34.0)	(73.0)	102.0	124.4	0.6	(31.4)
Debt/EBITDA (x)	3.6	(5.5)	1.0	0.8	36.6	26.3
Debt/debt and equity (%)	24.4	21.0	5.9	49.4	78.3	74.0

## Related Criteria And Research

All articles listed below are available on RatingsDirect on the Global Credit Portal, unless otherwise stated.

- Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Sept. 28, 2011
- Key Credit Factors: Criteria For Rating The Global Capital Goods Industry, April 28, 2011
- Criteria Methodology: Business Risk/Financial Risk Matrix Expanded, May 27, 2009
- Standard & Poor's Revises Its Approach To Rating Speculative-Grade Credits, May 13, 2008

### Ratings Detail (As Of November 29, 2011)

#### AEG Power Solutions B.V.

Corporate Credit Rating B-/Positive/--



<b>Ratings Detail</b> (As Of November 29, 2011) <b>(cont.)</b>	
<b>Corporate Credit Ratings History</b>	
10-Nov-2011	B-/Positive/--
11-Nov-2010	B-/Stable/--
<b>Business Risk Profile</b>	Vulnerable
<b>Financial Risk Profile</b>	Aggressive
<b>Debt Maturities</b>	
2011-2012: €11 mil.	
2013-2014: Nil	
2015: €100 mil. 9.25% notes	
*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.	

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